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C O N F I D E N T I A L SECTION 01 OF 02 MINSK 001164

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SUBJECT: SATISFYING THE MARKET IN A STATE-DOMINATED ECONOMY

REF: MINSK 1142

Classified By: Ambassador Karen Stewart for reason 1.4 (d).

Summary

¶1. (C) Profitable Belarusian businesses, even if they are completely privately owned, must respond in large part to the dictates of the state. This is especially true when private companies try to compete in the same markets with state-owned enterprises. The complex business environment, which even includes the risk of nationalization of property, partially shields local business from foreign entrants into their markets. Business can delicately lobby for piecemeal economic reforms, but have to couch their efforts in terms of the health of their entire industry. In doing so, business leaders demonstrate their tacit acceptance of Lukashenko's statist economic model. End summary.

¶2. (SBU) Emboffs spoke to executives in several of the most visible firms in Minsk catering to clients at the upper end of the economic spectrum: Viktor Petrovich, Director and partner in the holding company Tabak Invest, which opened Minsk's newest hypermarket; Inna Maslennikova, General Director of Merlintour, a travel agency specializing in individualized foreign tours; Sergey Kusonovskiy, Deputy Director of Milavitsa, a lingerie manufacturer and retailer focusing on the middle class and "middle class plus" market segments; Aleksey Dunayevskiy, Director of Sales and Marketing for Mir Fitnessa, the only gym in Minsk in a purpose built facility; Igor Razumovskiy, the General Director of Avtosalon-AV, the exclusive dealer in Belarus for Audi and Porsche; Aleksandr Parkhimchik, owner of several restaurants in Minsk; and Vitaliy Arbuzov of Fenox, a holding company for grocery stores and food imports.

Competition? What Competition? The State Worries Us

¶3. (C) All of the business leaders we spoke with believe their enterprises will continue to grow (reftel). The absence of worries about competitors accounts for much of the optimism. Executives forecast their markets will expand further, creating plenty of room for sales growth. This helps soften the resentment against regulations that greatly increase the cost of business. Merlintour, to take one case, has to employ five accountants to satisfy the reporting requirements of multiple agencies. Without regulations peculiar to Belarus, the company could get by with one or two accountants.

¶4. (C) All the businesses we surveyed had by definition successfully navigated the labyrinth of regulation by maintaining close ties with the government. For example, the

newest hypermarket in town, Korona, is owned by Tabak Invest, which reaps huge profits by annually winning government tenders to import cigarettes. The annual import quota is well below demand. Similarly, Arbuzov's company received part of the quota to import frozen fish into Belarus. The majority owner of Mir Fitnessa is the state-owned Belvneshekonombank.

15. (C) Successful business leaders feel comfortable dealing with bureaucracy as long as they do so on a level playing field with competitors. When private Belarusian businesses share a market with state enterprises, they run the risk of increased government interference. Merlintour, like all tour agents, must assist the largely state-owned hotel industry by generating at least ten percent of its revenues from selling in-bound tours. The limits of markets with state-owned competitors drove Tabak Invest to diversify from the cigarette market, in which it must subsidize loss-making state companies producing cheap Soviet-era brands, into markets with no state-owned competitor: hypermarkets and personal helicopters.

16. (C) The less than welcoming business climate helps existing businesses by increasing the cost for new entrants. Petrov said Russian companies flush with money are just now entering the hypermarket business in Minsk, but West European competitors are still too fearful to take the risk. Dunayevskiy remarked even Russian companies do not want to deal with the complex procedures for opening a fitness center in Minsk. Restaurateur Parkhimchik and entrepreneur Arbuzov said the temporary constraints against Russian competition helped their businesses.

Lobbyists Seek Safety in Numbers or Internal GOB Divisions

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17. (C) Keeping the government happy does not mean accepting all its decisions blindly. Industry associations allow businesses to approach the government with united positions, and sometimes result in meaningful changes in policy. Razumovskiy said the auto dealers association help draft legislation greatly reducing the tariffs on importing new cars.

18. (C) Milavitsa, as the dominant garment exporter in Belarus, maintains a close working relationship with a ministry-level state agency, Belleprom, which helps it negotiate with the Ministry of Economics. Working thru Belleprom, Milavitsa succeeded in getting itself removed from the list of monopolistic companies, thereby avoiding further regulation of its pricing. Milavitsa also worked with Belleprom to convince the government that the garment industry is in worse shape than agriculture. This swayed the GOB to return "agriculture support taxes" from companies in the garment industry back to the industry itself, rather than to support agriculture.

The Worst Case Scenario: Nationalization

19. (C) A complete failure to keep the government happy risks a company's very existence. In fact, press had speculated that placing Milavitsa on the list of monopolistic companies was a first step toward nationalization, with the next step being driving prices down to the point where the company was no longer profitable. The lack of a culture of respect for private property worries entrepreneurs. Arbuzov said he keeps no assets in his own name to reduce the risk of confiscation.

Comment: Would-be Capitalists Still Fulfill the Plan

110. (C) While the demand for high-end consumer goods

definitely exists (reftel), to one degree or another firms meeting this demand must also fit within Lukashenko's economic plan for Belarusian development. While often thought of as focusing on paying pensions on time and producing big machines, this unwritten plan includes showcasing successful Belarusian companies on billboards on the way in from the airport (Milavitsa was "strongly encouraged" to advertise) and the presence of some well-known foreign brands.

¶11. (C) Although entrepreneurial-minded Belarusians are able and willing to fulfill Lukashenko's plan in cases where genuine demand exists, they also must put up with regulation and taxation designed to support the rest of the plan. Entrepreneurs have managed the burden over the past decade of strong economic growth. How they will manage during an economic downturn if Russia withdraws generous energy subsidies may be quite another story.

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